BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
W. E. HALL COMPANY)

Appearances:

For Appellant: George G. Witter, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code frpm the action of the Franchise Tax Board on the protest of W. E. Hall Company to a proposed assessment of additional franchise tax in the amount of $7,358.80 for the income year 1953.

Appellant is a California corporation engaged in heavy construction work and the manufacture and sale of culvert steel tubes. During 1953, all of Appellant's stock was owned by members of the Hall family.

Pacific Steelfiber Drums, Inc., hereafter called Pacific was a wholly-owned subsidiary of Appellant which was engaged in the manufacture of fiber drums which were closed at each end by steel. In its manufacturing processes it employed certain basic patents belonging to a corporation called Fiber Steel Inc. In 1949, Pacific purchased all the outstanding shares of Fiber Steel, Inc. The contract of sale entitled the sellers to one-third of the proceeds in the event of a sale of any interest in the basic patents to any party outside of the Hall family or its corporations.

In 1950 the Hall family purchased the Fiber Steel, Inc., shares from Pacific, liquidated Fiber Steel, Inc., and placed the patents in a Hall family partnership. However, Pacific continued to manufacture the product and pay royalties until June 30, 1953.

The Hall family was also engaged in the manufacture of all-fiber drums, This activity was carried on by a corporation other than Pacific.

Early in 1953 the Hall family decided to sell to Rheem Manufacturing Company, an unrelated party, all the assets involved in the manufacture of fiber drums, including assets owned by Pacific and those owned by other persons and entities composing the Hall interests, but not including the basic patents previously mentioned. In May, 1953, Appellant adopted a resolution to wind up and dissolve Pacific as of June 30, 1953, and Pacific's

directors adopted the necessary motions to carry out the plan of dissolution. On June 15, 1953, several written contracts were entered into by various Hall entities agreeing to sell and deliver to Rheem certain specified assets owned or controlled by them. In one of these contracts, Appellant agreed to sell and deliver to Rheem on June 30, 1953, the manufacturing equipment, the inventory and certain applications for Letters Patent, all owned by Pacific, for $200,000. Schedules were attached to the contract which listed the assets to be sold. They consisted of about one-half of Pacific's assets and the basis of these assets in the hands of Pacific was $43,134.57.

On June 29, 1953, special meetings were held at which the boards of directors of both Pacific and Appellant passed resolutions authorizing a sale to Appellant of those assets of Pacific covered by the contract between Appellant and Rheem, at a price of ~200,000. On June 30, 1953, bills of sale which itemized the included assets were simultaneously prepared, transferring the assets from Pacific to Appellant and from Appellant to Rheem; Rheem's check for $100,000 was given to Pacific by Appellant; the balance of $100,000 was recorded by Pacific as due from Appellant; and Pacific was completely liquidated with Appellant assuming its liabilities, Pacific was dissolved on September 4, 1953.

Pacific reported a gain of $156,865.43 on its federal return in regard to the sale of the assets. Pacific filed no state return for the period ended September 4, 1953, since that was the last year during which it did business. Its income for that year was not includible in the measure of the franchise tax because of the prepayment feature of the franchise tax law. Appellant reported no gain from the sale to Rheem on the theory that it sold the assets for the same price that it had paid for them.

The Franchise Tax Board takes the position that the transfer of assets from Pacific to Appellant was in substance a distribution in complete liquidation of Pacific and, therefore, Appellant realized the gain since the assets retained their basis of $43,134.57. (See Rev. & Tax. Code §24504(b)(1), formerly 25071(1).) Appellant contends that it acquired the assets through a true sale, that its basis for the assets was thus the same as the price for which it sold them to Rheem and that it therefore received no gain from the sale to Rheem. (See Rev. & Tax Code $24912, formerly 25071.)

The incidence of taxation depends upon the substance of a transaction. (Commissioner v. Court Holding Co., 324 U.S. 331.) Although Appellant contends that the alleged sale was necessary to clearly-segregate the assets sold to Rheem from the basic patents so that no liability to the former patent owners would be incurred, it seems clear that the bill of sale to Rheem, which

included a detailed itemization of the assets involved, was adequate to insure against any possible liability in that regard, especially since Pacific had not owned the patents since 1950. We are of the opinion that Appellant's predominant motive in using the form of a sale to acquire the assets from Pacific was to minimize taxes. However, in United States v. Cumberland Public Service Co., 338 U.S. 451, the Supreme Court said that a motive of tax avoidance will not establish liability. Such transactions, nevertheless, are properly subject to careful scrutiny. (Sun Properties, Inc. v. United States, 220 F. 2d 171).

In-looking for the true nature of the transaction, we are impressed by the fact that on June 30, 1953, all of Pacific's assets were transferred to Appellant. Some of the assets were transferred in the form of a sale and the remainder were transferred through a distribution in complete liquidation. In regard to the alleged sale, Appellant gave nothing to Pacific that it did not on the same day retrieve through the complete liquidation of Pacific. In short, Appellant did not actually pay anything for the assets which it received beyond the surrender of the stock which it held in Pacific. A liquidation was originally planned and the net effect was precisely that.

It has been held in analogous federal cases that where all of the assets of a corporation are transferred to its stockholders in the form of a sale, the purported sale should be ignored and the transaction should be treated as a distribution in liquidation. (Benjamin H. Read, 6 B.T.A. 407; Cook v. United States, 3 F. Supp. 47; Edward R. Bacon Co., T.C. Memo, Dkt. No. 4043, Sept. 10, 1945, aff'd 158 F. 2d 981; Gaunt & Harris v. United States, 110 F. 2d 651; France Co. v. Commissioner, 88 F.2d 917, cert. denied 302 U.S. 699. Cf. C. M. Menzies, Inc., 34 B.T.A. 163.) The rationale of these cases is that liquidations in fact resulted, regardless of the form in which they were cast.

The cases cited by Appellant (Burnet v. Commonwealth Improvement Co., 287 U.S. 415; Sun Properites, Inc. v. United States, 220 F.2d 171; W. P. Hobby, 2 T.C. 980; Commissioner v. Eldridge, 79 F. 2d 629; Superior Oil Co, v. Mississippi, 280 U.S. 390) are not inconsistent with the foregoing decisions. None of them involved a sale resulting in or contemporaneous with a complete liquidation.

Appellant emphasizes that it paid full value for the assets which it purchased from Pacific. Any significance that might otherwise be attached to that factor is lost when it is considered that Appellant immediately retrieved the entire price upon the liquidation of Pacific.

It is also argued by Appellant that Pacific could have sold the assets directly to Rheem and there would have been no question that Pacific had realized the gain. For reasons presumably

sufficient to the parties in control, this was not done, and we are not called upon to speculate as to the effect of this alternative.

In view of the facts before us, we conclude that the purported sale from Pacific to Appellant was in substance a distribution in liquidation.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of W. E. Hall Company to a proposed assessment of additional franchise tax in the amount of $7,358.80 for the income year 1953 be and the same is hereby sustained.

Done at Sacramento, California, this 13th day of December, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary